

Message Text

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ACTION H-02

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E.O. 11652: N/A
TAGS: EAID, EFIN OREP
SUBJECT: SENATOR GRAVEL'S PAPER ON TAXATION FOR DEVELOPMENT AND
ASSISTANCE

REF: BUENOS AIRES 1119, STATE 9837

1. WE RECEIVED A LETTER FROM SENATOR GRAVEL DATED
DECEMBER 14 ENCLOSING HIS TAX PROPOSAL AND ASKING FOR OUR
COMMENTS. AFTER REVIEWING THE PROPOSAL, WE OFFER THE
FOLLOWING COMMENTS FOR THE DEPARTMENT'S USE IN REPLYING
TO SENATOR GRAVEL.

2. ALTHOUGH THE PRINCIPAL OBJECTIVES OF THE GRAVEL PLAN
ARE WORTHWHILE, THE MEANS PROPOSED FOR ACHIEVING THEM
ARE CUMBERSOME AND COULD LEAD TO SOME DIFFICULTIES.
SOME OF THESE ARE:

A) THE TAX PROPOSAL MIGHT ENCOURAGE SOME MULTINATIONAL
COMPANIES TO MOVE THEIR HEADQUARTERS FROM THE U.S. TO
TAX HAVENS ABROAD. THE DEPARTURE OF THESE COMPANIES WOULD
HAVE A NEGATIVE IMPACT ON THE U.S. ECONOMY.

B) THE PROPOSAL APPEARS TO ASSUME THAT U.S. MULTINATIONALS
PAY ENOUGH U.S. INCOME TAX ON U.S. SOURCE INCOME
AGAINST WHICH TO OFFSET THE TAX FOR DEVELOPMENT ASSIST-
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ANCE. IN THE CASE OF MANY MULTINATIONALS, PARTICULARLY
THE SMALLER ONES, THIS ASSUMPTION MAY NOT BE VALID.
THESE COMPANIES, THEREFORE, WOULD HAVE A MUCH HEAVIER
TAX BURDEN EVEN IF THEY COMPLIED WITH OECD CODE FOR MULTI-
NATIONALS.

C) THE PROPOSAL CALLS FOR DIVIDING THE REVENUE FROM

THE DEVELOPMENT ASSISTANCE TAX AMONG QUALIFYING COUNTRIES ACCORDING TO "WEIGHTS" AND CHANNELING THE FUNDS TO THE COUNTRY THROUGH VARIOUS CHANNELS, INCLUDING THE WORLD BANK AND OTHER IFI'S, THE UNDP, AND THE EDUCATIONAL TRUST FUND. THE GOAL OF CHANNELING A SET AMOUNT OF FUNDS TO EACH COUNTRY MAY AT TIMES CONFLICT WITH THE GUIDELINE THAT EACH IFI SHOULD USE ITS NORMAL CRITERIA IN APPROVING PROJECTS. FOR EXAMPLE, WHAT HAPPENS TO THE EXCESS FUNDS IF A PARTICULAR COUNTRY HAS INSUFFICIENT PROJECTS WHICH ARE WORTHY OF FINANCING?

D) THE STIPULATION ABOUT HUMAN RIGHTS MAY ALSO BE DIFFICULT TO ENFORCE IF THE FUNDS ARE BEING ADMINISTERED BY IFI'S WHERE THE U.S. HAS NO VETO POWER. THE IFI'S HAVE IN GENERAL RESISTED ALLOWING POLITICAL CONSIDERATIONS, INCLUDING HUMAN RIGHTS, FROM BEING DETERMINANTS IN THE APPROVAL OF LOANS.

E) AS THE PROPOSAL NOTES, MANY LDC'S, AND PARTICULARLY THOSE IN LATIN AMERICA, HAVE REFUSED TO BECOME SIGNATORIES TO THE ICSID AND IN GENERAL HAVE BEEN RELUCTANT TO SUBMIT INVESTMENT DISPUTES FOR ARBITRATION BY INTERNATIONAL TRIBUNALS. WHILE REGIONAL TRIBUNALS MAY BE MORE ACCEPTABLE TO SOME OF THE LDC'S, THE QUESTION REMAINS WHETHER SUCH TRIBUNALS WILL PROVIDE JUSTICE FOR THE U.S. MULTINATIONAL COMPANIES INVOLVED. THE REGIONAL CHARACTER OF SUCH TRIBUNALS COULD LEAD TO DECISIONS REFLECTING THE POLITICAL BIAS OF A SMALL GROUP OF COUNTRIES.

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3. AS AN ALTERNATIVE MEANS OF PURSUING THE SAME OBJECTIVES, WE RECOMMEND THE FOLLOWING APPROACH:

A) IN SENATOR GRAVEL'S PROPOSAL, THERE IS NO DIRECT LINK BETWEEN THE AMOUNT OF U.S. INVESTMENT IN AND THE AMOUNT OF DEVELOPMENT TAX ASSISTANCE FOR A PARTICULAR COUNTRY. IT THEREFORE DOES NOT SEEM NECESSARY TO USE U.S. FOREIGN INCOME AND TAXATION AS A BASIS OF ACHIEVING AN INCREASED FLOW OF AID. THIS OBJECTIVE COULD BE ACHIEVED MUCH MORE SIMPLY BY LEGISLATING APPROPRIATIONS BRINGING OUR AID TO THE .7 PERCENT GNP LEVEL FOR "QUALIFIED COUNTRIES", AS DEFINED IN SENATOR GRAVEL'S PROPOSAL. THESE FUNDS WOULD BE DEPOSITED IN THE SPECIAL ACCOUNTS IN THE IFI'S WHERE THE U.S. WOULD HAVE VETO POWER AND THUS BE ABLE TO BLOCK LOANS TO COUNTRIES HAVING HUMAN RIGHTS PROBLEMS OR DEALING UNFAIRLY WITH U.S. MULTINATIONAL COMPANIES. RATHER THAN ALLOCATING THE FUNDS BY "WEIGHTS", THE U.S. WOULD ALLOW THE IFI'S

TO USE THEIR NORMAL CRITERIA IN USING THE FUNDS FOR
PROJECTS IN QUALIFYING COUNTRIES.

B) TO INCREASE THE FLOW OF INVESTMENT BY U.S. MULTI-
NATIONALS TO "QUALIFYING COUNTRIES," "QUALIFYING
COMPANIES" AS DEFINED IN SENATOR GRAVEL'S PROPOSAL WOULD
BE ELIGIBLE FOR A TAX CREDIT ON NEW DIRECT INVESTMENT
TO THESE COUNTRIES. A SIMILAR PROPOSAL MET WITH
OPPOSITION FROM CONGRESS IN THE PAST, PRESUMABLY BECAUSE
THERE WAS CONCERN THAT FOREIGN INVESTMENT LED TO A NET
EXPORT OF U.S. JOBS. NOW THAT VARIOUS STUDIES SHOW
THAT OVERALL U.S. EXPORTS BENEFIT FROM FOREIGN INVEST-
MENT, ONE MAY EVEN COME TO THE CONCLUSION THAT THE
LABOR IMPACT IS FAVORABLE TO THE U.S.
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